Report

of the

Examination of

American Family Life Insurance Company

Madison, Wisconsin

As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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Jorge Gomez, *Commissioner*

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February 13, 2003

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Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
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Commissioners:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

AMERICAN FAMILY LIFE INSURANCE COMPANY
Madison, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1997 as of December 31, 1996. The current examination covered the intervening period ending December 31, 2001, and included a review of such 2002 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance. They reviewed the adequacy of aggregate life and accident and health reserves, dividends to policyholders, asset adequacy analysis, deferred and uncollected premiums for life insurance, due and uncollected premiums for health insurance, and in force testing. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

American Family Mutual Insurance Company (AFMIC)) incorporated American Family Life Insurance Company (AFLIC or the company) in 1957, as a stock life and disability insurance company. AFLIC is a wholly owned subsidiary of AFMIC through its downstream holding company, AmFam, Inc. Collectively AFMIC and subsidiaries are known as the American Family Insurance Group.

The company writes direct premium and annuity considerations in the following states:

Wisconsin	$ 65,467,742	22%
Missouri	39,502,868	13.5
Minnesota	36,412,658	12.0
Illinois	34,247,994	12.0
Colorado	19,873,858	7.0
All others	98,497,728	33.52
	$294,002,848*	100%

*Dividends applied to purchase paid-up additions and annuities, and premium and annuity considerations waived under disability or other contract provisions, are not included.

The company is currently licensed in the following states, with North Carolina and South Carolina added in 2002:

Arizona	Colorado	California
Idaho	Illinois	Indiana
Iowa	Kansas	Michigan
Minnesota	Missouri	Montana
Nebraska	Nevada	New Mexico
North Carolina	North Dakota	Ohio
Oregon	South Carolina	South Dakota
Utah	Texas	Washington
Wisconsin		

The major products marketed by the company include traditional whole, universal and term life insurance products. All products are marketed through AFMIC’s exclusive agency system.

In September 2000, the company obtained approval from the Commissioner to write variable universal life and variable annuity products. AFLIC started writing these products in May 2001. As of September 30, 2002 there were 732 AFMIC agents properly licensed to sell the new variable products.

The following chart is a summary of the net insurance premiums written by the company in 2001. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Ordinary life	$169,697,514	$ 0	$ 503,392	$169,194,122
Term Insurance	88,149,857	32,831	14,476,293	73,706,395
Universal life	48,374,221	0	535,520	47,838,701
Group Life	2,521,113	0	0	2,521,113
Individual annuities	16,542,550	0	0	16,542,550
Total All Lines	$325,285,255	$32,831	$15,515,205	$309,802,881

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors is elected annually, and consists of six members, each of whom is an officer of AFMIC. As inside directors, they receive no additional compensation for serving on the board. The current board of directors consists of the following persons:

Currently the board of directors consists of the following persons:

Name	Principal Occupation
Harvey R. Pierce	Chairman of the Board and Chief Executive Officer
David R. Anderson	President and Chief Operating Officer
Daniel R. DeSalvo	Executive Vice President – Sales
James F. Eldridge	Executive Vice President – Legal; Secretary
John B. Johnson	Executive Vice President – Finance, Treasurer
Darnell Moore	Executive Vice President, Administration
Joseph W. Tisserand	Senior Vice President – Variable Products
Jack C. Salzwedel	Vice President – Life/Health

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2001 Compensation
Harvey R. Pierce	Chairman of the Board and C.E.O.	$1,439,020*
David R. Anderson	President and Chief Operating Officer	836,786*
James F. Eldridge	Executive Vice President- Legal; Secretary	464,364*
John B. Johnson	Executive Vice President- Finance; Treasurer	548,041*
Thomas S. King	Vice President – Investments	407,102*
Daniel R. Schultz	Vice President – Controller	267,874*
Joseph W. Tisserand	Vice President – Life/Health	405,380*
James W. Behrens	Assistant Secretary	150,016*
William J. Smith	Assistant Treasurer	127,678*

*Compensation noted above is on an American Family Group basis, and includes amounts allocated to all affiliates.

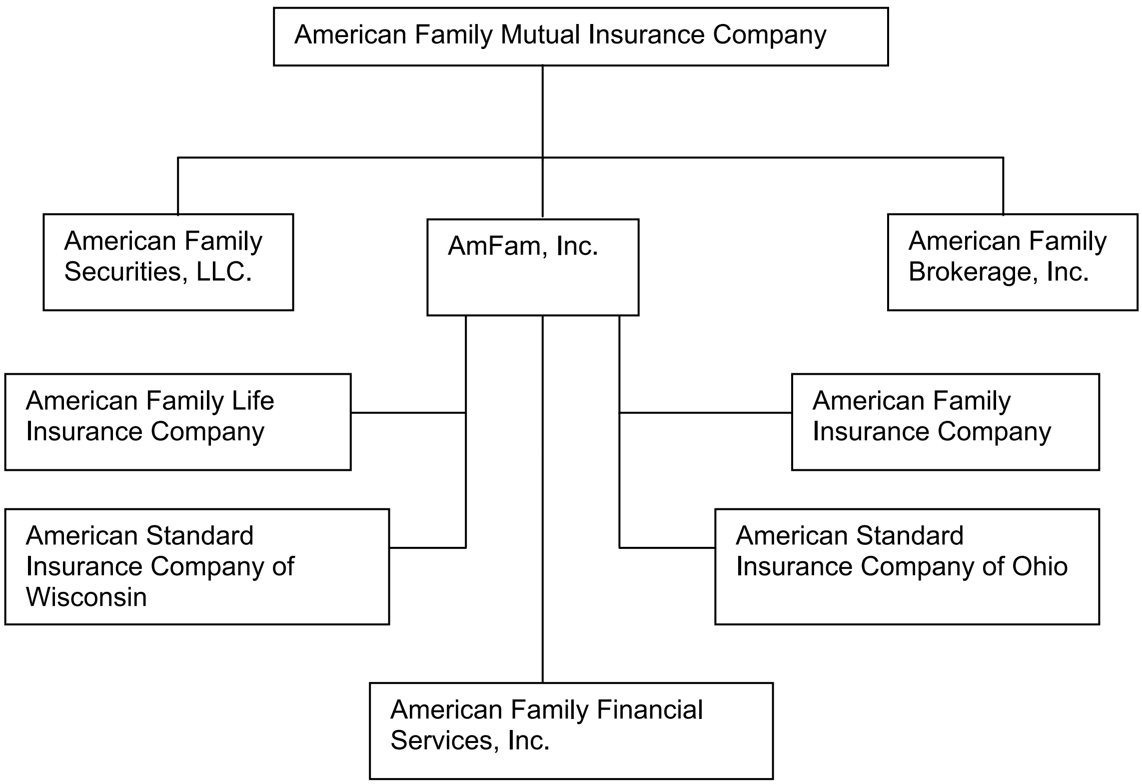
Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. There were no committees appointed by the board at the time of the examination. The committees of the ultimate controlling party AFMIC provide guidance to AFLIC's board.

IV. AFFILIATED COMPANIES

American Family Life Insurance Company (AFLIC] is a member of a holding company system refer to as American Family Group. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the affiliates of AFLIC follows the organizational chart.

Organizational Chart
As of December 31, 2001



American Family Mutual Insurance Company

American Family Mutual Insurance Company (AFMIC) is the parent of the holding company system referenced above. AFMIC was organized in 1927, and writes primarily auto and homeowner's coverage in 22 states. AFMIC 100% assumes the business written by its downstream property and casualty subsidiaries. As of December 31, 2001 AFMIC reported assets of $6.8 billion and liabilities of $4.2 billion, surplus of $2.6 billion, and net income of $11 million. AFMIC was examined concurrently with AFLIC. The results of that examination are described in a separate report.

AmFam, Inc.

AmFam, Inc., was incorporated in 1981 to serve as a downstream holding company for the American Family Insurance Group. As of December 31, 2001, the company's consolidated audited financial statement reported, on a GAAP basis, assets of $4.2 billion, liabilities of $3.3 billion and stockholder's equity of $900 million. Of that amount, all but approximately $241,000 was derived from the value of subsidiaries.

American Family Brokerage, Inc.

American Family Brokerage, Inc., was incorporated in 1985, to provide brokerage services for insurance placements beyond the coverage or limits available through the American Family Insurance Group. As of December 31, 2001, the company's GAAP basis audited financial statement reported assets of $1.5 million, liabilities of $1.34 million, and stockholder's equity of $165,000. Operations for 2001 produced a net income of $192,000.

American Family Securities, LLC

American Family Securities, LLC (AFS), was incorporated on July 14, 2000, with a capital contribution of $250,000 from AFMIC, as a limited liability company whose sole member is AFMIC. AFS is a non-clearing, registered broker dealer acting as the principal underwriter for American Family Life Insurance Company's (AFLIC) new variable life and annuity products. On March 23, 2001, AFS was admitted into the National Association of Securities Dealers (NASD) to sell AFLIC's variable products. As of December 31, 2001, the company's GAAP basis audited financial statement reported member's equity of $264,000. Operations for 2001 produced a net income of $11,000.

American Family Financial Services, Inc.

American Family Financial Services, Inc. (AFFS), was acquired by American Family Insurance Group in 1969, to provide direct loans and leases, primarily to policyholders. It offers these products through AFMIC"s multi-line, exclusive agency force in twenty-two states. As of December 31, 2001, the company's GAAP basis audited financial statement reported assets of

$202 million, liabilities of $180 million, and stockholder's equity of $22.7 million. Operations for 2001 produced a net income of $721,000.

AFFS finances its loan portfolio primarily through the sale of commercial paper. In order to allow the company to receive the best possible interest rates, AFMIC has agreed to guarantee the debt of AFFS. In 1998, the Board of Directors of AFMIC authorized an increase in the guarantee limit to $375 million. As of December 31, 2001, AFFS outstanding guaranteed debt totaled $92 million. In addition, both AFMIC and AFLIC lend AFFS additional funds through the use of short-term notes. As of December 31, 2001, there were no outstanding short-term notes issued by AFFS owed to an affiliate.

American Standard Insurance Company

American Standard Insurance Company of Wisconsin (ASIC) was incorporated in 1961. The company is currently licensed in 22 states, and is limited to providing insurance for motorcycles and for marginal and substandard private passenger automobile risks. ASIC's direct writings are 100% ceded to AFMIC. As of December 31, 2001, ASIC reported assets of $274 million, liabilities of $92 million, and surplus of $182 million. ASIC was examined concurrently with AFLIC. The results of the examination are described in a separate report.

American Standard Insurance Company of Ohio

American Standard Insurance Company of Ohio (ASICO) was incorporated in Ohio in 1995 and writes business only in that state. ASICO was incorporated for the purpose of operating efficiencies and tax savings. ASICO writes lines of business identical to those of ASIC and cedes that business to AFMIC through a 100% quota share agreement. As of December 31, 2001, ASICO reported assets of $25.8 million, liabilities of $21.6 million and policyholders' surplus of $4.2 million. Operations for 2001 produced a net income of approximately $425,000.

American Family Insurance Company

American Family Insurance Company (AFIC) was incorporated in Ohio in 1995 and writes business only in that state. AFIC was founded for the purposes of operating efficiencies and state tax savings. AFIC writes lines of business identical to those of AFMIC. The direct writings are then ceded to AFMIC through a 100% quota share agreement. As of

December 31, 2001, AFIC reported assets of $59.7 million, liabilities of $52 million and policyholders' surplus of $7.7 million. Operations of 2001 produced net income of approximately $663,000.

Affiliated Agreements

In 1995, AFMIC developed an inter-company cost allocation agreement for the reimbursement of expenses paid by AFMIC on behalf of its affiliates. Allocated costs are based on the actual cost of providing the service multiplied by the affiliates' proportionate share of the benefit conferred. Refer to the "Summary of Examination Results" section of this report for further discussion on this topic.

Effective April 29, 2002, AFMIC and affiliates entered into a restated tax allocation agreement for the purpose of filing federal income tax returns on a consolidated basis. The tax liability of the group is allocated to individual member companies in accordance with Internal Revenue Service regulations. Each participating affiliate reimburses AFMIC for payment of the affiliate's portion of liability included in the consolidated tax liability, and each respective affiliate receives its pro-rata share of consolidation-basis tax benefits.

V. REINSURANCE

AFLIC's reinsurance program consists primarily of ceding large risks ($750,000 or more on standard risks) to several different reinsurance companies. Ceding contracts are either coinsurance or yearly renewable term. Since January 1997, AFLIC has ceded 100% of the excess above $750,000. AFLIC normally does not write many risks over the retention of $750,000. As a result, ceded premium was approximately 1% of gross premium for a majority of the years under examination. This percentage of premium ceded increased to 5% in 2001 when AFLIC entered into a new coinsurance agreement with Security Life of Denver Insurance Company to cover 10-year and 20-year level term policies. Under this new contract the company retained 10% of each policy up to its standard life retention of $750,000 for 2001. Also in 2001, AFLIC entered into a new agreement with Life Reassurance Corporation of America to cover the new variable universal life policies. The terms of the contract provided for 100% coverage over the $750,000 retention.

Reinsurance assumed in 2001 represents less than .001% of gross writings. This amount pertains to a canceled contract, in run-off, that was reviewed during the prior examination.

All coverages are placed with reinsurers directly by AFLIC. A review of the reinsurers participating under these agreements, showed that all are companies licensed or authorized to do business in Wisconsin. The examiners found that the company adequately reviews security rankings of its reinsurers. All contracts reviewed contain proper insolvency provisions.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2001, annual statement to the Commissioner of Insurance. Also included in this section are schedules which reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Any adjustment made as a result of the examination is noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

American Family Life Insurance Company
Assets
As of December 31, 2001

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$2,062,000,187	$	$2,062,000,187
Stocks:			
Common stocks	94,295,148		94,295,148
Mortgage loans on real estate:			
First liens	187,497,764		187,497,764
Policy loans	160,139,717		160,139,717
Cash	3,574,629		3,574,629
Short-term investments	42,422,232		42,422,232
Other invested assets	6,202,281		6,202,281
Receivable for securities	567,410		567,410
Reinsurance ceded:			
Amounts recoverable from reinsurers	517,360		517,360
Federal and foreign income tax recoverable and interest thereon	36,971,246		36,971,246
Guaranty funds receivable or on deposit	1,343,934	161,298	1,182,636
Investment income due and accrued	32,291,559		32,291,559
Receivable from parent, subsidiaries and affiliates	1,838,596	116,462	1,722,134
Other assets nonadmitted:			
Cash advanced to or in hands of officers or agents	5,458,769	5,458,769	0
Write-ins for other than invested assets:			
Temporary travel advances	150	150	0
Returned checks	232,843	232,843	0
Receivable for mortality and expense fees	3,333		3,333
From Separate Accounts Statement	3,534,803	0	3,534,803
Total Assets	$2,638,891,961	$5,969,522	$2,632,922,439

American Family Life Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2001

Aggregate reserve for life policies and contracts	$1,950,707,394	
Liability for deposit-type contracts	280,079,411	
Policy and contract claims:		
Life	13,650,717	
Policyholders' dividends and coupons due and unpaid	(56,566)	
Provision for policyholders' dividends and coupons payable in following calendar year:		
Apportioned for payment to December 31, 2002	43,264,458	
Not yet apportioned	1,194,258	
Premiums and annuity considerations received in advance	403,093	
Commissions to agents due or accrued	3,781,760	
General expenses due or accrued	22,737,640	
Transfers to separate accounts due or accrued (net)	(60,701)	
Taxes, licenses, and fees due or accrued, excluding federal income taxes	3,449,251	
Unearned investment income	4,799,101	
Amounts withheld or retained by company as agent or trustee	10,353,227	
Miscellaneous liabilities:		
Asset valuation reserve	16,583,922	
Payable to parent, subsidiaries and affiliates	20,746,969	
Write-ins for liabilities:		
Liability for checks charged off	192,349	
Reserve for retired lives	535,338	
Payable for reinsurance	36,067	
Reserve for clearing accounts	233,274	
Litigation settlements payable	13,653,649	
From Separate Accounts Statement	3,534,803	
Total Liabilities		2,389,819,414
Common capital stock	2,500,000	
Gross paid in and contributed surplus	1,000,000	
Unassigned funds (surplus)	239,603,025	
Capital and Surplus		243,103,025
Total Liabilities, Surplus, and Other Funds		$2,632,922,439

American Family Life Insurance Company
Summary of Operations
For the Year 2001

Premiums and annuity considerations for life and accident and health policies and contracts	$309,802,880	
Considerations for supplementary contracts with life contingencies	846,612	
Net investment income	171,480,353	
Amortization of interest maintenance reserve	24,684	
Commissions and expense allowances on reinsurance ceded	11,784,718	
Miscellaneous income:		
Income from fees associated with investment management administration and contract guarantees from separate accounts	11,575	
Write-ins for miscellaneous income:		
Other	(162)	
Total income items		$493,950,660
Death benefits	60,138,469	
Matured endowments	203,569	
Annuity benefits	20,649,859	
Disability benefits and benefits under accident and health policies	1,810,661	
Surrender benefits and withdrawals for life contracts	61,656,823	
Group conversions	334,592	
Interest and adjustments on policy or deposit-type contract funds	15,943,858	
Payments on supplementary contracts with life contingencies	978,538	
Increase in aggregate reserve for life and accident and health policies and contracts	125,558,044	
Subtotal	287,274,413	
Commissions on premiums, annuity considerations, and deposit-type contract funds (direct business only)	29,261,577	
General insurance expenses	81,919,649	
Insurance taxes, licenses, and fees excluding federal income taxes	7,157,940	
Net transfers to or (from) Separate Accounts	3,425,466	
Write-in for deductions:		
Litigation settlements	(850,747)	
Total deductions		408,188,298
Net gain from operations before dividends to policyholders and federal income taxes		85,762,362
Dividends to policyholders		39,202,822
Net gain from operations after dividends to policyholders and before federal income taxes		46,559,540
Federal income taxes incurred (excluding tax on capital gains)		21,532,919
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses)		25,026,621
Net realized capital gains or (losses) less capital gains tax and amount transferred to the IMR		(2,758,198)
Net Income		$22,268,423

American Family Life Insurance Company
Cash Flow
As of December 31, 2001

Premiums and annuity considerations for life and accident and health policies and contracts		$309,949,418	
Considerations for supplementary contracts with life contingencies		846,612	
Net investment income		169,424,766	
Commissions and expense allowances on reinsurance ceded		11,784,718	
Fees associated with investment management, administration and contract guarantees from separate accounts		11,575	
Total			$492,017,089
Death benefits	59,058,492		
Matured endowments	203,569		
Annuity benefits	20,649,859		
Disability benefits and benefits under accident and health policies	5,722		
Surrender benefits and withdrawals for life contracts	61,656,823		
Group conversions	334,592		
Payments on supplementary contracts with life contingencies	978,538		
Subtotal		142,887,595	
Commissions on premiums, annuity considerations, and deposit type contract funds	28,415,465		
General insurance expenses	84,150,226		
Insurance taxes, licenses and fees, excluding federal income taxes	6,563,643		
Net transfers to or (from) Separate Accounts	3,486,167		
Subtotal		265,503,096	
Dividends paid to policyholders		47,366,977	
Federal income taxes (excluding tax on capital gains)		10,571,903	
Total deductions			323,441,976
Net cash from operations			$168,575,113
Proceeds from investments sold, matured, or repaid:			
Bonds	328,962,483		
Stocks	11,205,195		
Mortgage loans	17,125,750		
Other invested assets	58,616		
Net gains or (losses) on cash and short-term investments	(8)		
Miscellaneous proceeds	3,342,569		
Subtotal	360,694,605		
Less: Net tax on capital gains	1,056,048		
Total		359,638,557	

Less: Cost of investments acquired (long-term only):

Bonds	361,378,154		
Stocks	107,311,606		
Mortgage loans	29,820,000		
Total investments acquired		498,509,760	
Net increase in policy loans and premium notes		10,480,778	
Net cash from investments			(149,351,981)
Cash provided from financing and miscellaneous sources:			
Deposits on deposit-type contract funds and other liabilities without life or disability contingencies	17,604,867		
Other cash provided	2,457,824		
Total		20,062,691	
Cash applied for financing and miscellaneous uses:			
Withdrawals on deposit-type contract funds and other liabilities without life or disability contingencies	22,892,427		
Other applications	2,506,764		
Total		25,399,191	
Net cash from financing and miscellaneous sources			(5,336,500)
Net change in cash and short-term investments			13,886,632

Reconciliation

Cash and short-term investments, December 31, 2000	32,110,229
Cash and short-term investments, December 31, 2001	$45,996,861

American Family Life Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2001

Assets		$2,632,922,439	
Less liabilities		2,389,819,414	
Adjusted surplus			$243,103,025
Annual premium:			
Individual life and health	290,885,754		
Less Dividends	45,995,190		
Total	244,890,565		
Factor	15%		
Total		$36,733,585	
Group life and health	2,521,113		
Less Dividends	1,371,787		
Total	1,149,326		
Factor	10%		
Total		$114,933	
Greater of 7.5% of consideration or 2% of reserves for annuities and deposit administration funds		3,532,383	
Compulsory surplus (subject to a $2,000,000 minimum)			40,380,901
Compulsory surplus excess or (deficit)			$202,722,124
Adjusted surplus			$243,103,025
Security surplus: (133% of compulsory surplus, based on premium volume)			53,706,597
Security surplus excess or (deficit)			$189,396,428

American Family Life Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2001

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999	2000	2001
Capital and surplus, beginning of year	$238,032,133	$253,667,896	$175,648,867	$176,103,784	$190,430,437
Net income	11,004,259	(64,603,621)	2,950,740	15,205,294	22,268,423
Change in net unrealized capital gains or (losses)	27,024	662,837			(1,093,058)
Change in net deferred income tax					27,153
Change in non-admitted assets and related items	(5,135,712)	(793,478)	(80,067)	98,558	(288,760)
Change in reserve on account of change in valuation bases		(11,881,674)	(1,062,663)		
Change in asset valuation reserve	8,430,954	(1,403,093)	(1,353,093)	(977,199)	(5,104,432)
Cumulative effect of changes in accounting principles					36,863,262
Capital changes:					
Transferred from surplus			1,500,000		
Surplus adjustments:					
Transferred to capital			(1,500,000)		
Write-ins for gains and (losses) in surplus:					
Prior year federal income tax	1,309,238				
Capital and surplus, end of year	$253,667,896	$175,648,867	$176,103,784	$190,430,437	$243,103,025

American Family Life Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2001

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios can be found after the IRIS ratios.

	Ratio	1997	1998	1999	2000	2001
#1	Net change in capital & surplus	7.0%	-31.0*%	0.0%	8.0%	28.0%
#2	Gross change capital & surplus	7.0	-31.0*	0.0	8.0	28.0
#3	Net income to total income	3.0	-15.0*	1.0	3.0	5.0
#4	Comm and Exp to Prem and Deposits	Discontinued				
#5	Adequacy of investment income	283.0	278.0	223.0	225.0	215.0
#6	Non-admitted to admitted assets	0.0	0.0	0.0	0.0	0.0
#7	Total real estate & mortgage loans to cash & invested assets	5.0	6.0	6.0	7.0	7.0
#8	Total affl investments to capital & surplus	1.0	1.0	1.0	1.0	1.0
#9	Surplus relief	0.0	1.0	1.0	1.0	5.0
#10	Change in premium	6.0	6.0	6.0	4.0	2.0
#11	Change in product mix	0.0	0.2	0.0	0.4	.3
#12	Change in asset mix	0.3	0.1	0.1	0.2	.6
#13	Change in reserving ratio	-1.0	-4.0	-1.0	9.0	-10.0

Ratio No. 1 and 2 compare changes in surplus between the current and prior year. Exceptional results are over 50% or under –10%. The unusual ratios for 1998 are due to AFLIC being named defendant in a class action lawsuit. In 1998, AFLIC established a $65 million liability for potential settlement costs. The $65 million was a deduction to income, which also caused ratio No. 3 to be unusual that year. The lawsuit is further discussed in the Summary of Examination Results section under "Disappearing Premium Lawsuit". Another factor contributing to an exceptional result for ratio No. 3 in 1998 was increased expenses due to consulting fees incurred for the implementation of a new life point-of-sale application processing system.

Growth of American Family Life Insurance Company

Year	Admitted Assets	Liabilities	Surplus
1997	$2,052,660,261	$1,798,992,365	$253,667,896
1998	2,178,867,628	2,003,218,761	175,648,867
1999	2,308,806,287	2,132,702,503	176,103,784
2000	2,430,180,095	2,239,749,658	190,430,437
2001	2,632,922,439*	2,389,819,414*	243,103,025

*Including Separate Accounts business of $3,534,803

Life Insurance In Force (in thousands)

Year	Gross Direct And Assumed	Ceded	Net
1997	$40,244,376	$977,341	$39,267,035
1998	44,956,911	1,012,285	43,944,626
1999	49,463,980	1,093,427	48,370,553
2000	53,716,596	1,794,137	51,922,459
2001	57,568,136	7,535,238	50,032,898

As mentioned above, the company's surplus was adversely affected by a class action lawsuit filed in 1997 with the potential liability reported in 1998. During 1999, AFLIC settled the lawsuit making $11 million in payments, but still reported a liability of $57.6 million.

Ceded insurance in force increased in 2001 due to the company's decision to cede 90% of its 10 and 20 year level term to Security Life of Denver. Refer to the Reinsurance section of this report for a discussion on this contract.

Reconciliation of Surplus per Examination

The examination made no adjustments to the company's reported surplus as regards policyholders or reclassifications of any balance sheet items.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were two specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Finance Committee—It is recommended that the company amend its by laws to allow for the appropriate delegation of managerial authority to the committee.

   Action—Compliance

2. Write-in Item for Prior Year Federal Income Tax—It is recommended that the company include all usual and ordinary adjustments to federal income taxes within the income statement, and not as a direct adjustment to surplus.

   Action—Compliance

Summary of Current Examination Results

Financial Reporting – Schedule Y

During the review of affiliated agreements it was noted that the company did not report any amounts on Schedule Y, Part 2 - Column 8 - Management Agreements and Service Contracts. AFLIC is a party to two such agreements with American Family Mutual Insurance Company (AFMIC), a cost sharing and a tax allocation agreement. These agreements are discussed in the "Affiliated Agreements" section of this report.

NAIC Annual Statement Instructions – Life/Accident/Health provide in Schedule Y, Part 2, an insurer shall report all revenues and expenditures under intercompany contracts for services provided by the insurer, including income tax amounts resulting from tax-sharing agreements, from other affiliates subject to a materiality test. However, under s. Ins 40.03 (5), Wis. Adm. Code, "any transaction related to a management, exclusive agency or similar agreement or which is a service contract or cost-sharing arrangement is a material transaction". It is recommended that the company report in Schedule Y of its statutory annual statements all transactions among affiliates relating to the cost-sharing and income tax allocation agreements in compliance s. Ins 40.03 (5), Wis. Adm. Code.

Subsequent to examination fieldwork the company has reported transactions between affiliates in the 2002 Schedule Y, Part 2, under Management Agreements and Service Contracts.

Invested Assets

AFMIC entered into a custodial agreement, effective January 1, 1983, with First Wisconsin National Bank on behalf of American Family Group for the safekeeping of most of the group's securities, including securities of AFLIC. The examiners' review of this custodial agreement indicated that it did not contain the following clause, as recommended by the NAIC in the Financial Condition Examiners Handbook:

> If there is a loss of securities for which the custodian is obligated to indemnify the company, either the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

Also, the clause in the agreement about indemnification by the custodian did not contain all of the NAIC recommended language as included below:

> The custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the custodian's custody occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction.

The review also noted that the agreement had not been updated since inception in 1983. During that time the name of the custodial bank had changed from First Wisconsin to Firstar and recently U. S. Bank bought Firstar. Also, the agreement mentions Midwest Securities Trust Company (MSTC) as a limited purpose trust company. The agreement states that certain securities are to be deposited in MSTC's non-proprietary account. However, references to MSTC are no longer valid as AFMIC now uses Depository Trust Company. It is recommended that the company amend the custodial agreement to include the language recommended by the NAIC's Financial Condition Examiners Handbook, to replace references to Midwest Securities with the current trust company, and to replace the custodian with the current one.

During fieldwork the company initiated meetings with U.S. Bank officials to change the custodial agreement in order to address the issues raised by this examination, among other changes desired by the company.

Amounts Withheld or Retained by Company for Account of Others

The examiner's review of this account noted that it contained cash receipts that were being held in suspense accounts until proper allocation could be determined, such as premium receipts for a new policy. According to the NAIC's Accounting Practices and Procedures Manual SSAP 67, this liability should contain amounts the company is holding in a fiduciary capacity such as employees' federal tax withholdings. The NAIC's Accounting Practices and Procedures Manual SSAP 67 also states that unallocated cash receipts are considered Remittances and Items not Allocated. It is recommended that the company comply with the NAIC's Accounting Practices and Procedures Manual SSAP 67 and the NAIC's Annual Statement Instructions – Life/ Accident/Health for the reporting unallocated cash receipts.

Disabled Lives Reserve (Waiver of Premium)

Disabled lives reserve is established for policyholders who, due to disability, are on waiver of premium status. Those policyholders are no longer required to make premium payments. As part of the examination, the company provided a detail listing of the Disabled Lives Reserve balance. During testing of this listing, the examiner noted exceptions between the reserve detail and the policy administration system (Vantage) in regards to the benefit amount. The benefit amount refers to the individual policyholder's full-term premium that is being waived due to disability. The examiner noted that in some instances the benefit amount reported in the reserve detail was the modal premium (i.e.: monthly or quarterly payment) rather than the annual premium.

Since the actuarial department uses the information from the Vantage system for its reserve reporting, and assumes an annual premium for the purposes of calculating the Disabled Lives Reserve, the established reserve for some of the policies was erroneously based on the modal premium. The examiner notified the company about these discrepancies. Upon review, AFLIC's actuarial department determined that the information from the Vantage system contained, in some cases, the wrong codes which led to the benefit amount being modal instead of annual. Prior to the examination, the company had been unaware of this coding problem. The actuarial department estimated that approximately 10% of the reserves were understated due to this coding issue.

The examiners also noted that no reserve was established for one of the selected disabled policyholder's claim file. According to claim file documentation, this policyholder was approved for waiver of premium status. For that particular claim, the claim department had made manual entries using codes that the actuarial department was not aware of. These types of errors were part of the estimated understatement. It is recommended that the company address the coding errors found during the examination so that the benefit amount is the annual premium for all policyholders on waiver of premium, and that all claimants are properly recognized. Due to materiality, no adjustment to surplus was made as a result of this recommendation.

Reserves for Life Reserves and Policy Benefits

This office contracted the services of an independent actuary for the review and determination of life reserve and policy benefits adequacy. The independent actuary performed procedures, and determined that reserves for losses and loss adjustment expense:

- Meet the requirements of the insurance laws of Wisconsin
- Are computed in accordance with accepted loss reserving standards, and
- Make a reasonable provision for all unpaid policy benefits under the terms of its policies and agreements.

However, the office's independent actuary made one recommendation concerning future reserving methods. It was noted that the incurred but not reported (IBNR) portion of the Policy and Contract Claims liability is determined by looking at historical amounts on a quarterly basis and taking the average of the past several quarters. Using this method for 2001, AFLIC reported IBNR represented approximately one week of paid claims.

The actuary noted in the report that the data received from the company showed large increases in IBNR over the past years. It was felt that for an increasing block of business an average amount would tend to understate the reserve. However, in the opinion of the office's actuary, the current reserve was sufficient. It is recommended that the company review its methodology on setting the IBNR liability of Policy and Contract Claims in future valuations to ensure continued adequacy.

"Disappearing Premium" Lawsuit

The prior examination report made reference to lawsuits that were filed against the company in 1997. The suits sought to obtain class action status by including all policyholders who purchased whole life or universal life (the Class Policies) between 1983 and 1996 (the Class Period). The allegations were that American Family representatives incorrectly told potential policyholders that after making a stated number of premium payments, they would not have to make any more. This became known as the "disappearing premium" issue.

AFLIC denied the allegations, but it believed that resolution of all issues would limit additional expense and burden upon operations. AFLIC reported $65 million in settlement cost expense and liability on its 1998 annual statement.

The company agreed to a settlement in 1999 as follows: 1) In force Traditional Class Policies with a dividend option of Accumulate at Interest or Paid-Up Additions received an addition to their dividend values. 2) In force Universal Life Class Policies received an addition to their cash value. 3) In force Traditional Class Policies with a dividend option of Pay in Cash or Reduce Premium received payment distributed by a third party administrator.

It was determined during the settlement process that an individual with an ownership interest in a policy where the insured died prior to June 1, 1999, while the policy was in force and a death benefit was paid or payable, would not be part of the settlement class. If a policy was "non-active" (i.e. had lapsed or surrendered) during the class period, those class members were given three choices: 1) Opt out of the class; 2) Stay in class and accept the general policy relief; 3) File an election form to participate in the individual claim review process. Depending on the results of the review process, the claimant had a choice of either restoring the policy or receiving a cash payment. If the result of the review was that no harm was done, the claimant received nothing.

As of December 31, 1999, AFLIC reported an additional litigation expense of $3.6 million, the litigation liability decreased to $57.6 million as a result of $11 million of settlement payments. During 2000, the company made about $42 million in settlement payments and reported a liability of $15.5 million at year-end. By December 31, 2001 the liability was $13.6 million and settlement payments in 2001 were $1.8 million. The majority of claimants in 2000 and 2001 elected to receive compensation through an increase in policy value ($851,000 in 2001 and $34 million in 2002). As of September 30,2002, the liability had been reduced to $4.7 million, and the company anticipated total settlement by the end of 2003.

VIII. CONCLUSION

AFLIC is in a holding company system referred to as the “American Family Insurance Group.” AFLIC writes primarily ordinary and universal life products in 25 states using AFMIC’s exclusive multi-line agency system. In 2000 the company obtained authorization to write variable life and variable annuity products. In 2001, the company started selling its new variable products. As of September 30, 2002, AFLIC had 732 agents properly licensed to sell these new products.

During 1997, the company was named in a class action lawsuit alleging that the number of premium payments had been misrepresented to certain policyholders. AFLIC denied the allegations, but it believed that resolution of all issues would limit additional expense and burden upon operations. AFLIC reported a potential settlement amount of $65 million in 1998 and reached agreement on the settlement in 1999. As of September 30, 2002, the liability had been reduced from $65 million, reported in 1998, to $4.7 million and the company anticipated total settlement by the end of 2003.

The examination determined that the company complied with the two prior recommendations. The current examination made five recommendations and no adjustment to reported surplus or reclassification of balance sheet items. A review of the 2002 annual statement indicated that one of these recommendations had already been complied with.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 - Schedule Y— It is recommended that the company report in Schedule Y of its statutory annual statements all transactions among affiliates relating to the cost sharing and income tax allocation agreements in compliance with s. Ins. 40.03 (5), Wis. Adm. Code.

2. Page 24 - Invested Assets— It is recommended that the company amend the custodial agreement to include the language recommended by the NAIC's Financial Condition Examiners Handbook, to replace references to Midwest Securities with the current trust company, and to replace the custodian with the current one.

3. Page 24 - Amounts Withheld or Retained by Company for Account of Others— It is recommended that the company comply with the NAIC's Accounting Practices and Procedures Manual SSAP No. 67 and the NAIC's Annual Statement Instructions – Life, Accident and Health for the reporting of cash receipts that cannot be identified for a specific purpose.

4. Page 25 Disabled Lives Reserve—It is recommended that the company address the coding errors found during the examination so that the benefit amount is the annual premium for all policyholders on waiver of premium, and that all claimants are properly recognized.

5. Page 26 Policy and Contract Claims—It is recommended that the company review its methodology on setting the IBNR liability of Life Policy and Contract Claims in future valuations to ensure continued adequacy.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Andy Fell	Insurance Financial Examiner
Amy Wolff	Insurance Financial Examiner
John Litweiler	Insurance Financial Examiner
Rebecca Easland	Insurance Financial Examiner
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Randy Milquet	EDP Specialist

Respectfully submitted,

Eleanor Oppriecht
Examiner-in-Charge